MACC PRIVATE EQUITIES INC
Form 10-Q
February 22, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark one)

R QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2010

£ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to __________

Commission file number 0-24412

MACC PRIVATE EQUITIES INC.
(Exact name of registrant as specified in its charter)

Delaware	42-1421406
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2533 South Coast Highway 101, Suite 240,
Cardiff-By-The-Sea, California 92007
(Address of principal executive offices)

(760) 479-5080
(Registrant’s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant has (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes R No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 or Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes £   No £

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	o	Non-accelerated filer	þ	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o   No þ

At February 1, 2011, the registrant had issued and outstanding 2,464,621 shares of common stock.

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PART I -- FINANCIAL INFORMATION

Item 1. Financial Statements

MACC PRIVATE EQUITIES INC.
Condensed Balance Sheets

		December 31, 2010 (Unaudited)	September 30, 2010
Assets			
Cash and cash equivalents	$	220,731	135,094
Loans and investments in portfolio securities, at fair value:			
Unaffiliated companies (cost of $710,507 and $732,032)		482,712	1,201,524
Affiliated companies (cost of $6,072,436 and $6,072,436)		6,283,560	5,867,593
Controlled companies (cost of $1,644,508 and $2,867,127)		1,165,933	2,157,533
Interest receivable		32,356	24,255
Other assets		964,782	188,786
Total assets	$	9,150,074	9,574,785
Liabilities and net assets			
Liabilities:			
Notes payable	$	2,663,029	3,367,928
Incentive fees payable		16,361	16,361
Accounts payable and other liabilities		216,501	242,417
Total liabilities		2,895,891	3,626,706
Net assets:			
Common stock, $.01 par value per share; authorized 10,000,000 shares; issued and outstanding 2,464,621 shares		24,646	24,646
Additional paid-in-capital, net of accumulated net investment income (loss) and net realized gain (loss)		6,724,783	6,368,378
Unrealized depreciation on investments		(495,246)	(444,945)
Total net assets		6,254,183	5,948,079
Total liabilities and net assets	$	9,150,074	9,574,785
Net assets per share	$	2.54	2.41

SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS

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MACC PRIVATE EQUITIES INC.
Condensed Statements of Operations
(Unaudited)

		For the three months ended December 31, 2010	For the three months ended December 31, 2009
Investment income:			
Interest			
Unaffiliated companies	$	18,057	16,936
Affiliated companies		46,114	57,358
Controlled companies		1,448	217,990
Loss on receivable		---	(241,843)
Other		28	118
Dividends			
Affiliated companies		123,594	42,632
Total investment income		189,241	93,191
Operating expenses:			
Interest expenses		49,441	71,063
Management fees		46,472	62,132
Professional fees		158,851	90,965
Other		74,860	69,958
Total operating expenses before waivers		329,624	294,118
Expenses reduced by Advisor		(23,236)	(31,066)
Total operating expenses		306,388	263,052
Net investment loss		(117,147)	(169,861)
Realized and unrealized gain (loss) on investments:			
Net realized gain (loss) on investments:			
Unaffiliated companies		824,383	---
Affiliated companies		(350,831)	---
Net change in unrealized appreciation/depreciation on investments		(50,301)	(323,671)
Net gain (loss) on investments		423,251	(323,671)
Net increase (decrease) in net assets resulting from operations	$	306,104	(493,532)

SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS

MACC PRIVATE EQUITIES INC.
Condensed Statements of Changes in Net Assets
(Unaudited)

	For the three months ended December 31, 2010	For the three months ended December 31, 2009
Operations:		
Net investment loss	$(117,147)	(169,861)
Net realized gain on investments	473,552	---
Net change in unrealized depreciation/appreciation on investments	(50,301)	(323,671)
Net increase (decrease) in net assets resulting from operations	306,104	(493,532)
Net assets:		
Beginning of period	5,948,079	7,809,388
End of period	$ 6,254,183	7,315,856

SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS

MACC PRIVATE EQUITIES INC.
Condensed Statements of Cash Flows
(Unaudited)

	For the three months ended December 31, 2010		For the three months ended December 31, 2009	
Cash flows provided by (used in) operating activities:				
Net increase (decrease) in net assets resulting from operations	$ 306,104		(493,532	)
Adjustments to reconcile net increase (decrease) in net assets from operations to net cash provided by operating activities:				
Net realized and unrealized (gain) loss on investments	(423,251	)	323,671	
Proceeds from disposition of and payments on loans and investments in portfolio securities	881,124		155,042	
Purchases of loans and investments in portfolio securities	---		(33,342	)
(Increase)/decrease in interest receivable	(8,101	)	236,725	
Decrease in other assets	60,576		31,835	
Increase (decrease) in accrued interest, deferred incentive fees payable, accounts payable and other liabilities	(25,916	)	10,950	
Net cash provided by operating activities	484,432		724,881	
Cash flows used in financing activities:				
Note repayment	(704,899	)	(124,034	)
Net cash used in financing activities	(704,899	)	(124,034	)
Net increase in cash and cash equivalents	85,637		107,315	
Cash and cash equivalents at beginning of period	135,094		173,521	
Cash and cash equivalents at end of period	$ 220,731		280,836	
Supplemental disclosure of cash flow information - Cash paid during the period for interest	$ 49,441		70,312	
Supplemental disclosure of non-cash investing and financing information - In-kind interest income received in the form of securities	$ 368,7633		241,843	

SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS

MACC PRIVATE EQUITIES INC.

Notes to Unaudited Condensed Financial Statements

(1) Basis of Presentation

The accompanying unaudited condensed financial statements include the accounts of MACC Private Equities Inc. ("MACC," "we" or "us") and have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for investment companies. MACC has elected to be treated as a business development company under the Investment Company Act of 1940, as amended. Effective April 30, 2008, MACC's wholly-owned subsidary, MorAmerica Capital Corporation, ("MorAm"), was merged with and into MACC.

The unaudited condensed financial statements included herein have been prepared in accordance with GAAP for interim financial information and instructions to Form 10-Q and Articles 6 and 10 of Regulation S-X. Accordingly, certain information and note disclosures normally included in annually audited financial statements prepared in accordance with GAAP have been omitted, however MACC believes that the disclosures made are adequate to make the information presented not misleading. The unaudited condensed financial statements should be read in conjunction with the audited financial statements and notes thereto of MACC as of and for the year ended September 30, 2010 included in the MACC's Form 10-K, as filed with the Securities and Exchange Commission (the "SEC"). The information reflects all adjustments consisting of normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of the results of operations for the interim periods. The results of the interim periods reported are not necessarily indicative of results to be expected for the year.

Significant Risk and Uncertainties

When global economic conditions are adverse or the global economy is in a recession as it was during Fiscal 2010 and the first quarter of Fiscal 2011, it is difficult for us to estimate future expected realizable value from investments, the likelihood of our portfolio companies' ability to meet their financial obligations, including the debentures and related interest payments due to us, and therefore our future expected cash flows. All of these factors increase uncertainty inherent in management's estimates and assumptions. As future events and their effects cannot be determined with precision, particularly those related to the condition of the economy and the performance of the investments, we believe actual results related to our realization on the sale of investments, collection of loans receivable and interest receivable presently pose our greatest risk and could differ significantly from our current estimates.

(2) Going Concern Uncertainty and Liquidity

MACC has a positive net change in net assets from operations of $306,104 for the three months ended December 31, 2010 and generated net cash flow from operations of $484,432 to fund our operating activities and financing requirements for the three months ended December 31, 2010 and for ongoing operating expenses. Operating expenses have been funded primarily from the sale of portfolio companies, dividends, and interest received.

MACC continues to have an ongoing need to raise cash from portfolio sales to fund our operations and pay down outstanding debt. MACC's efforts to sell certain investments has taken longer than we initially anticipated while performance of the underlying portfolio companies in certain cases has deteriorated. MACC believes its ability to liquidate positions had been adversely affected by credit conditions and the downturn in the financial markets and the global economy. MACC had a Note Payable with Cedar Rapids Bank & Trust Company ("CRB&T") with a balance of $2,663,029 as of December 31, 2010 and due and payable January 10, 2011 ("Note Payable"). Effective January 10, 2011, MACC executed a fifth amendment to the business loan agreement (“Fifth Amendment”) whereby CRB&T extended the maturity of the Note Payable to July 11, 2011 and removed the covenant requiring MACC to complete a capital transaction to raise additional operating capital for the Company.

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On January 6, 2011, the Company received net proceeds of $836,572 from the merger transaction of one of its portfolio companies, Monitronics International, Inc. (the "Transaction"). An additional amount of approximately $58,571 has been placed in an escrow account and may be released to the Company upon the satisfaction of certain conditions of the Transaction.

On January 10, 2011, the Company paid $671,341 to CRB&T in the form of a principal payment on the Note Payable. Subsequent to the payment, the balance of the Note Payable on January 10, 2011 was $1,991,688. After the payment on the outstanding Note Payable, the Transaction provided the Company with $165,231 of additional working capital.

At MACC's annual shareholder meeting held on November 30, 2010, shareholders voted against giving MACC the ability to raise additional capital through the issuance of shares of common stock at a price below MACC's then-current net asset value per share. In addition shareholders voted against allowing MACC the ability to issue warrants, options or rights to subscribe for or convert into common stock. Without these authorizations to sell shares at below net asset value or issue options or warrants, MACC's ability to raise funding through the capital markets is highly unlikely.

As a result of the shareholder actions, the Board of Directions will review a number of alternatives and evaluate potential exit opportunities to maximize return on investment, including seeking shareholder approval to liquidate. At the same time, we will continue to seek additional cash through future sales of portfolio equity and debt securities and from other financing arrangements. Absent additional sources of financing, current working capital and cash will not be adequate for operations at their current levels. If such efforts are not successful, MACC may need to liquidate its current investment portfolio, to the extent possible, which could result in significant realized losses due to the current economic conditions.

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future, and do not include any adjustments to reflect the possible future effects of the inability to continue to operate as a going concern.

(3) Critical Accounting Policies

Investments

Investments in securities that are traded in the over-the-counter market or on a stock exchange are valued by taking the end of day close price (or bid price in the case of over-the-counter equity securities) for the valuation date. Restricted and other securities for which quotations are not readily available are valued at fair value as determined by the Board of Directors. Among the factors considered in determining the fair value of investments are the cost of the investment; developments, including recent financing transactions since the acquisition of the investment; financial condition and operating results of the investee; the long-term potential of the business of the investee; market interest rates for similar debt securities; overall market conditions and other factors generally pertinent to the valuation of investments. Because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

In the valuation process, we use financial information received monthly, quarterly, and annually from our portfolio companies which includes both audited and unaudited financial statements. This information is used to assist in assessing financial condition, performance, and valuation of the portfolio investments.

Realization of the carrying value of investments is subject to future developments. Investment transactions are recorded on the trade date and identified cost is used to determine realized gains and losses. Under the provisions of authoritative guidance, the fair value of loans and investments in portfolio securities on February 15, 1995, MACC's fresh-start date, is considered the cost basis for financial statement purposes.

Accounting Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period.

Actual results could differ from these estimates. Current economic conditions, including illiquid credit markets, volatile equity markets, and deteriorating economic conditions contribute to the inherent uncertainty of such estimates. Management's estimates and assumptions are reviewed periodically, and the effects of revisions are reflected in the unaudited condensed financial statements in the periods they are determined to be necessary.

(4) Recent Accounting Pronouncements

In January 2010, the FASB issued authoritative guidance that requires reporting entities to make new disclosures about recurring and non recurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. The FASB also clarified existing fair-value measurement disclosure guidance about the level of disaggregation, inputs, and valuation techniques. The new and revised disclosures are required to be implemented in annual and interim reporting periods beginning after December 15, 2010. We are currently evaluating the impact of adopting this standard on MACC's financial position and results of operations.

(5) Fair Value Measurements

Investments

MACC follows the accounting guidance on fair value measurements. In part, this guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value. The guidance establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability used in measuring investments at fair value. Market price observability is affected by a number of factors, including the type of investment and the characteristics specific to the investment. Investments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value. MACC's practices reflect recent authoritative guidance that requires reporting entities to make new disclosures about recurring and non recurring fair-value measurements including significant transfers into and out of Level I and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. MACC also follows FASB's recent clarification of existing fair-value measurement disclosure guidance about the level of disaggregation, inputs and valuation techniques.

MACC frequently makes investments in separate debt, equity and mezzanine instruments in the same portfolio company. Most of these companies also have senior secured debt from unaffiliated commercial lenders. The investment securities vary in security and seniority of payment, whether the company makes scheduled payments or the instruments are paid on a sale of the company. Valuation takes into account the value of the portfolio company as a whole, and the relative value of individual securities within that portfolio company's capital structure. Generally, MACC exits a portfolio company when the entire company is sold. When a portfolio company is sold, following payment of senior debt, the most recently issued debt of that company generally has the most security or seniority, followed by previously issued debt, then preferred equity, with common stock having the least seniority. Unrealized depreciation is therefore applied to equity securities first, then to the individual preferred and debt securities based on their seniority/security in the capital structure. In addition, while valuations takes into account the interest rate on debt securities, the factors discussed above significantly impact value in addition to the contracted rate.

MACC updates its schedules of investments with the most current information available at the date of the report. In certain instances a debt instrument may be due, but cannot be paid due to senior debt covenants. While extension terms of the notes may be in negotiation, these negotiations may not be complete as of the date of the report. These same instruments may retain value as the principal amount, and all accrued interest, may be paid with priority over other interests in the company. Similarly, because of the senior commercial loan covenants or company performance, the investor group and a portfolio company may have agreed to defer interest payments, but the value of the instrument remains based on the company value and priority of the instrument in the capital structure.

Taking these factors into account, MACC's investment valuations are based on industry specific information and earnings before interest, taxes, depreciation and amortization ("EBITDA") multiples obtained from third party sources, like-transactions, as well as contractual provisions such as investor put rights.

Investments measured and reported at fair value are classified and disclosed in one of the following categories:

Level 1 – Quoted prices are available in active markets for identical investments as of the reporting date. The type of investments included in Level 1 include listed equities and listed derivatives.

Level 2 – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies. Investments which are generally included in this category include corporate debt and less liquid and restricted equity securities.

Level 3 – Pricing inputs are unobservable for the investments and includes situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant management judgment or estimation and are based on the Board of Director's own assumptions about the assumptions that a market participant would use, including inputs derived from extrapolation and interpolation that are not corroborated by observable market data. Investments that are included in this category generally include corporate private equity.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the determination of which category within the fair value hierarchy is appropriate for any given investment is based on the lowest level of input that is significant to the fair value measurement. MACC's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the investment.

All of MACC's investments at December 31, 2010 were classified and disclosed under the Level 3 category. Investments are stated at fair value as determined by the Board of Directors according to the procedures of MACC's Valuation Policy. Securities are valued individually as of the end of each quarter of each fiscal year and as of the end of each fiscal year. Interest-bearing securities are carried at the approximate amount of fair value. Loan valuation determinations take into account portfolio companies' financial condition, outlook, payment histories and other factors. Equity security valuations take into account the following factors, among others: the portfolio company's performance, the prospects of a portfolio company's future equity financing and the character of participants in such financing, and the utilization of various financial measures, including cash flow multiples, as appropriate. If a portfolio company appears likely to discontinue operations, a liquidation valuation technique may be employed. The Board of Directors also considers credit market conditions, and the risks and uncertainties associated with those conditions in determining the values of its portfolio securities. Valuations established by the Board of Directors are not necessarily indicative of amounts which may ultimately be realized as a result of future sales or other dispositions of portfolio assets, and these favorable or unfavorable differences could be material.

The following tables present the investments at fair value as of December 31, 2010 and September 30, 2010 by type of investment:

Fair Value Measurement as of December 31, 2010

Fair Value Based on	Corporate Private Debt	Corporate Private Equity (1)	Total
Investment Level 3	$ 5,030,105	$2,902,100	100%

(1) represents $548,512 in preferred shares; $904,827 in common shares; $1,114,988 in membership interests, and $333,773 in escrow.

Fair Value Measurement as of September 30, 2010

Fair Value Based on	Corporate Private Debt	Corporate Private Equity (1)	Total
Investment Level 3	$ 6,092,445	$3,134,205	100%

(1) represents $557,848 in preferred shares; $1,698,638 in common shares; $802,215 in membership interests, and $75,504 in escrow.

The following tables provide a rollforward in the changes in fair value for the three months ending December 31, 2010 and 2009 for all investments which MACC has determined using unobservable (Level 3) factors.

For the three months ended December 31, 2010		Total
Balance, September 30, 2010		$9,226,650
Purchases (Debt Repayment)		
Linton Truss Corporation	$ (9,336)	
Morgan Ohare, Inc.	(7,813)	
Monitronics International, Inc.	(836,572)	
Spectrum Products, LLC	(863,975)	
Total Purchases (Debt Repayment)		(1,717,696)
Realized Gain (Loss)		
Linton Truss Corporation	(30,700)	
Monitronics International, Inc.	855,083	
Spectrum Products, LLC	(350,831)	
Total Realized Gain (Loss)		473,552
Unrealized Gain (Loss)		
Aviation Manufacturing Group, LLC	312,774	
Detroit Tool Metal Products Co.		